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RUEHKO/AMEMBASSY TOKYO 3107
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RUEHBI/AMCONSUL MUMBAI 5558
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RUCPDO/DEPT OF COMMERCE WASHDC
RHEFDIA/DIA WASHINGTON DC
RHEHAAA/NATIONAL SECURITY COUNCIL WASHINGTON DC
RHHMUNA/HQ USPACOM HONOLULU HI
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UNCLAS SECTION 01 OF 05 COLOMBO 001093

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STATE FOR SCA/INS AND EEB/IFD/ODF
MCC FOR S. GROFF, D. TETER, D. NASSIRY AND E. BURKE
TREASURY FOR LESLIE HULL

E.O 12958: N/A

TAGS: [EAID](#) [ECON](#) [EINV](#) [PTER](#) [CE](#)

SUBJECT: SRI LANKA: EAST DEVELOPMENT -- TRINCOMALEE NOT READY TO
REALIZE POTENTIAL

REF: A) COLOMBO 971 B) COLOMBO 1057 C) COLOMBO 882 D) COLOMBO
1003

¶1. (SBU) SUMMARY: Trincomalee, the eastern seaboard town boasting one of Asia's finest natural harbors, is underdeveloped and depressed as a result of over two decades of civil war in Sri Lanka. The government wants to translate its recent reassertion of control over the east into development, much of it based around Trincomalee's great economic potential. It has designated a Trincomalee Special Economic Zone into which it hopes to attract foreign investors. But the government's overly centralized approach to development and the still unsettled security situation make it likely that Trincomalee will continue to languish for many years. End summary.

TRINCOMALEE: AWESOME NATURAL HARBOR, DEPRESSED TOWN

¶2. (SBU) Trincomalee, on Sri Lanka's east coast, has been renowned for centuries for its large, deep, and protected natural harbor. If Sri Lanka had not been at war for the last quarter century, Trincomalee now surely would be a major import and export hub. Instead, it is depressed, dilapidated, and barely developed. A 2001 census estimated the town's population at 26,000, down from 44,000 in 1981. Rice farming remains the major occupation for the district's 395,000 residents. The Government of Sri Lanka, having recently re-established control over the country's east (ref A), believes it is now possible finally to tap Trincomalee's potential.

¶3. (SBU) In October 2006, the Board of Investment established a Special Economic Zone on 679 square kilometers spreading out from the harbor. The Board hopes to attract foreign investors to establish a mix of light and heavy manufacturing, a power plant, agriculture, and tourism attractions like whale watching and water

sports. The harbor makes Trincomalee's raw potential obvious, but the possibility that the ethnic separatist Liberation Tigers of Tamil Eelam (LTTE) could again emerge in the vicinity as a threat to economic activity may keep investors on the sidelines until the area proves truly peaceful. Econoffs and USAID staff visited Trincomalee July 31-August 2 to assess the economic environment in light of the government's impending release of a plan for how it envisions developing the Eastern Province (ref B).

SOLDIERS AND POLICE EVERYWHERE

14. (SBU) Trincomalee has been a hotspot in Sri Lanka's long war against the LTTE and related civilian violence. In April 2006 Singhalese rioters burned shops and homes belonging to Tamils following a bomb explosion in a local market and claymore mine attacks on soldiers in Trincomalee. Twenty civilians died in the violence and an estimated 1,000 Tamils fled their homes. There have been smaller episodes since then, and the town and district are under virtual lockdown. The military and police maintain a series of checkpoints on the main road into town; all vehicles are stopped at these. Bus passengers get out and walk through a physical search aisle, getting back on their buses 50 meters down the road. Trucks are checked carefully for explosives. Backlogs at the checkpoints can cause waits of 30 minutes or more. In town, fully helmeted and body-armored soldiers, police, and home guards carrying automatic weapons are everywhere. Many keep their faces covered with black bandanas. Pedestrians are unable to walk more than 100 meters without being checked for identification and questioned. Security forces routinely walk into shops along their patrol routes. Sri Lanka's largest navy base, a major air force training base, and an army division are all located in Trincomalee.

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SMALL AND MEDIUM ENTERPRISES: STRUGGLING AND ALIENATED

15. (SBU) The Chamber of Commerce and Industry of Trincomalee, formed in 2002, is housed in a non-airconditioned office whose only automation is a handful of computers donated by USAID. The Chamber's 164 members are small and medium size enterprises in such fields as construction, rice milling, small hotels and retail sales. Chamber board members told us that, aside from rice production, business is poor. There is little commerce aside from trade in food and daily essentials in produce markets and small shops. Many residents depend on remittances from relatives working abroad. Entrepreneurs have little access to financing, as banks are reluctant to lend money for investments that could fail if the security situation declines again. For example, building contractors seeking to bid on projects financed by the World Bank and the Asian Development Bank have found some banks unwilling to issue bid bonds and performance bonds unless the contractors could post 100% deposits on the value of the bonds.

16. (SBU) Chamber members gave a pessimistic assessment of the government's plans to revitalize Trincomalee with a Special Economic Zone. The government did not consult local businesses before establishing the zone. Residents are worried that they will be forced to move to make way for outside investors. They would be willing to move if they could be trained to work in the new enterprises, but the lack of consultation makes them doubt whether they will see real benefits from the changes. Some Chamber members also suspect that Tamils and Muslims in particular would be dislocated and unable to benefit from development. They noted that many Tamils and Muslims had left the area because they felt insecure and said that the Karuna paramilitary group had moved into some unoccupied homes belonging to these people.

THREE BIG MANUFACTURERS: INSULATED FROM STRIFE, READY TO EXPAND

17. (SBU) In contrast to the Chamber members' concerns, managers of three large foreign-owned industrial operations in Trincomalee described a secure and profitable business environment. The three

facilities lie nearby one another in the China Bay section of Trincomalee harbor, where each has its own jetties in 9 to 15 meter-deep water, capable of berthing all but the very largest cargo ships in use today. These operations find the harbor highly conducive to import of raw materials that they then process on-site and conveniently load onto rail, truck, or back onto ships for transport elsewhere in Sri Lanka or abroad. Each dominates its market in Sri Lanka and plans to expand operations. These companies have head offices in Colombo and have no difficulty consulting with government officials as needed.

- Lanka Indian Oil Company was formed in 2003 when Indian Oil Company (IOC) bought a third of the fuel storage and retail sales outlets of state-owned Ceylon Petroleum Corporation. The deal gave Lanka IOC ownership of a network of 150 filling stations around the country and possession, on a 35 year lease, of an oil tank farm in Trincomalee built by the British during World War II. Lanka IOC will soon complete an expansion enabling it to mix lubricant oils onsite for sale in Sri Lanka and for export. Lanka IOC is also interested in building an oil refinery. Security guards account for a third of the company's 150 staff in Trincomalee.

- Tokyo Cement, a Japanese-Sri Lankan joint venture that is 45% publicly owned, has the largest market share -- 30% -- of the five cement brands in Sri Lanka. It produces 2.4 million tons of cement

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per year, and is currently expanding to double the output of its Trincomalee plant. The total investment amounts to \$100 million in plants in Colombo and Trincomalee, including a new 10-megawatt biomass power plant that will power the Trincomalee facility and yield excess power for sale to the national grid. The plant employs 1135.

- Singaporean flour company Prima operates one of the largest flour mills in the world, producing 2,600 metric tons of wheat flour per day, some of which it exports. Prima is the only wheat flour producer in Sri Lanka, but has some competition from imported flour. It currently imports 95% of its wheat from Canada and about 5% from the United States. Prima employs 400 permanent and 250 part-time employees. It has applied to the Board of Investment to expand its operation to include food processing facilities and a warehouse next to its flour mill.

CENTRAL GOVERNMENT'S AGENT: ENFORCING SECURITY

18. (SBU) Retired Army Major General T T R De Silva is the District Secretary in Trincomalee, appointed by President Rajapaksa in June

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2006 and responsible for all aspects of civilian administration. He is the first retired military officer to serve in the normally civilian role, which comes under the Ministry of Public Administration and Home Affairs and which many still refer to by its former designation, "Government Agent." De Silva, who previously held commands over military forces in the East and Colombo, has drawn criticism from civil society organizations both foreign and domestic for his military approach to governance. With us he appeared concerned almost exclusively with ensuring security in Trincomalee. When asked about talk that the government would erect a fence along the ring road it was building around Trincomalee, he confirmed the plan (but did not want it widely known), analogizing the beaten LTTE to embers that could ignite again if exposed to a breeze. The fence would help prevent this, he explained, by making it easier for security forces to patrol Trincomalee's perimeter and to seal and search the town if necessary.

19. (SBU) De Silva shared the Board of Investment's vision of Trincomalee hosting a range of economic activities including industry, agriculture, fishing and canning, handicraft production, and tourism. He seemed intent on convincing India that Sampur, on Trincomalee's remote southern peninsula, was the best location for a proposed 500-megawatt coal-fired power plant joint venture that the two governments have been discussing for the past few years. De Silva clearly liked the idea of replacing the formerly LTTE-infested

Sampur jungle with a major Indian installation whose security would help ensure that the LTTE stayed out. (Note: Indian High Commission Econ chief recently told Econoff that, as reported in the press, India is in no rush to proceed with the power plant and is waiting for the government of Sri Lanka to propose other possible Trincomalee sites besides Sampur.)

¶10. (SBU) De Silva told Emboffs that, despite parts of Trincomalee being designated as High Security Zones (ref C), and much of the area now categorized as a Special Economic Zone, no residents would be displaced against their will. He believed consultation with local business people had been adequate: "They can tell the Board of Investment what they want." He downplayed reports that the Karuna group routinely moved around Trincomalee at night armed and unchallenged by police or the army, saying they were used to being armed and would feel insecure without their weapons. Instead, he asserted "we don't let them carry guns at night."

PROVINCIAL OFFICIALS: IN TOUCH, BUT OUT OF MONEY

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¶11. (SBU) Provincial level officials from the Ministry of Agriculture are working hard to help local farmers improve their productivity, according to the Ministry Secretary for the Eastern Province. They state that 65% of area residents are dependent on agriculture, but that the sector was badly hurt by the protracted fighting, which caused fields to go untended, livestock to scatter into the wild, and irrigation facilities to fall into disrepair. Addressing these needs was one priority for the ministry; another was attracting large investment into rice and maize production in order to significantly increase output. However, the ministry allots its provincial officials very little money and insufficient staff for these needs. International NGOs provide more funds than does the central government, but for very specific activities.

¶12. (SBU) The Board of Investment and the Sri Lanka Ports Authority also have offices in Trincomalee; both are caretaker operations with all policy and most operational matters handled in Colombo. The Board of Investment had six people, but five have returned to Colombo. The remaining official, S. Satkunalinkam, told us that Phase I of the planned industrial zone had been demarcated on land formerly belonging to the Sri Lanka Port Authority. Contrary to the Government Agent's assurance, he said that about 5,200 families would have to be moved out of the 1635-acre zone. He thought they would not object though, as they would be given new homes and would have the opportunity to find jobs (Note: Colombo officials told us they expect the zone to produce 30,000 jobs). Satkunalinkam said he knew the Trincomalee Chamber of Commerce people, but gave no sign that he consulted with them regularly.

¶13. (SBU) The Ports Authority runs a small port operation that loads and unloads roughly one ship a month -- usually an inbound shipment of coal for a cement factory on Sri Lanka's west coast and an outbound shipment of mineral sand bound for Russia, plus occasional military vessels bound for Jaffna with relief supplies. The port owns three tugboats that help dock the cargo ships coming and going from the Lanka IOC, Tokyo Cement, and Prima jetties. For this the port has 668 unionized civil servant employees -- far more than needed, but their positions cannot be eliminated.

COMMENT: GOVERNMENT'S TOP DOWN APPROACH WILL
ADVANCE POLITICAL OVER ECONOMIC GOALS

¶14. (SBU) Trincomalee's near-term future is dependent on two interlinked variables: the central government and the security situation. Neither gives much cause for optimism. The central government is not an effective planner and manages to mire most of its initiatives in bureaucracy. For example, Prima's expansion plans, though quickly approved by the Board of Investment, have been tied up for months with the Central Environmental Authority. Provincial officials are more in touch with local needs than are central bureaucrats and politicians, but with Sri Lanka allocating only fifteen percent of the national budget to provincial and

district level government operations, the provincial officials lack sufficient resources to make a difference.

¶15. (SBU) As for the security situation, the LTTE will likely remain a destabilizing force. Following its retreat from the east, it stated that it would attack military, government, and economic targets. Shortly after, it appears to have assassinated the Chief Secretary of the Eastern Provincial Council (ref D). In this light,

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the government's preoccupation with security in Trincomalee is understandable. However it is not confidence-inspiring; nor will a fence around the town send a positive signal to international investors or even to skilled Sri Lankans whom new enterprises will need to recruit from elsewhere in the country. For these reasons,

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Trincomalee still appears many years away from reaching its economic potential.

MOORE